BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D.C. 20551

DIVISION OF BANKING
SUPERVISION AND REGULATION

SR 13-21

December 17, 2013

**TO THE OFFICER IN CHARGE OF SUPERVISION
AT EACH FEDERAL RESERVE BANK AND TO HOLDING COMPANIES WITH TOTAL CONSOLIDATED ASSETS OF $10 BILLION OR LESS**

SUBJECT: Inspection Frequency and Scope Requirements for Bank Holding Companies and Savings and Loan Holding Companies with Total Consolidated Assets of $10 Billion or Less

Applicability: This letter applies to bank holding companies and savings and loan holding companies with $10 billion or less in total consolidated assets.

The Federal Reserve relies on periodic on- and off-site inspections to assess the safety and soundness of supervised bank holding companies and savings and loan holding companies (hereafter referred to as holding companies). This SR letter updates the minimum inspection frequency and scope requirements for supervised holding companies with total consolidated assets of $10 billion or less[1] to:

- Conform inspection frequency and scope requirements for savings and loan holding companies (SLHCs) with total consolidated assets of $10 billion or less to those applicable to bank holding companies of the same size;
- Clarify the scoping requirements for targeted inspections conducted at bank and SLHCs with total consolidated assets between $1 and $10 billion; and
- Modify the requirement for targeted inspections for "3," "4," and "5"-rated bank holding companies with total consolidated assets between $1 and $10 billion.

With the exception of the addition of SLHCs, the inspection scope and frequency expectations for holding companies with less than $1 billion in total consolidated assets have not changed.

These frequency and scope requirements vary depending on whether a holding company has been designated "complex," with more complicated holding companies subject to more

[1] With the issuance of this letter, SR letter 02-1, "Revisions to Bank Holding Company Supervision Procedures for Organizations with Total Consolidated Assets of $5 Billion or Less" is superseded.

frequent and in-depth review. If needed for supervisory purposes, Reserve Banks may inspect a holding company with greater frequency and scope than described in this guidance.

Definition of "Complex" Holding Companies

The determination of whether a holding company is "complex" should be made at least annually by the responsible Reserve Bank. Utilizing surveillance screens and other information obtained through supervisory or applications processes, Reserve Banks should update the complexity designation of a company as its activities or condition changes. The determination of a holding company's complexity should take into account a number of factors. These factors include the size and structure of the company; the extent of intercompany transactions between insured depository institution subsidiaries and the holding company or uninsured subsidiaries of the holding company; the risk, scale and complexity of activities of any nondepository subsidiaries;[2] and the degree of leverage at the holding company, including the extent of its debt outstanding to the public. Companies should also be designated "complex" if material risk management processes for the holding company and its affiliates are consolidated at the parent company.

Supervision and Surveillance Approach

The frequency and scope of on- and off-site inspections should be adjusted based on the results of examinations of a company's depository institution subsidiaries and off-site quarterly surveillance. Whether the inspection is conducted on- or off-site will depend on the level and nature of the risks involved, the holding company's ability to manage those risks, and the Reserve Bank's ability to acquire the necessary information to analyze the activity off-site. If information obtained off-site is not sufficient for the Reserve Bank to determine the condition or assess the activity of the company to assign a rating, the Reserve Bank should conduct an on-site inspection (full-scope or targeted, as appropriate).

To facilitate prompt follow-up on changes in a company's performance and condition, the Federal Reserve maintains distinct surveillance programs for small holding companies (less than $1 billion in total consolidated assets) and all other holding companies. Surveillance screens for holding companies with $1 billion or more in total consolidated assets focus on identifying those companies reporting financial results that seem to be inconsistent with their current supervisory ratings, as well as activities conducted outside of depository institution subsidiaries. For small holding companies, quarterly surveillance screens focus on the identification of potential parent company and nondepository subsidiary issues that may adversely affect affiliated depository institutions. In particular, these screens address parent company cash flow, intercompany transactions, parent company leverage, and consolidated capital ratios, when applicable. Screens also assist in maintaining up-to-date complexity designations and are updated periodically to reflect industry trends and conditions as well as changes in regulatory reporting requirements.

[2] For SLHCs, consideration should be given to whether the holding company is a grandfathered unitary savings and loan holding company, and if so, the type and extent of the activities in which the company engages.

Frequency and Scope of Inspections of Holding Companies with Total Consolidated Assets between $1 and $10 billion

Complex holding companies in satisfactory condition are inspected at least once per calendar year, while noncomplex holding companies may be inspected every other year. The Reserve Banks should attempt to conduct inspections of holding companies between $1 and $10 billion in total consolidated assets shortly after the examination of the lead depository subsidiary is completed. Holding companies between $1 and $10 billion in total consolidated assets are assigned a complete RFI rating (component ratings, subcomponent ratings, and a composite rating) regardless of their complexity.[3]

Depending on their condition and complexity, holding companies in this category will receive full-scope inspections or targeted inspections. At a minimum, a full-scope inspection should include sufficient procedures to reach an informed judgment regarding the assigned ratings for the factors addressed by the RFI rating system, evaluating the organization's methods of managing and controlling its risk exposures, and ascertaining whether management and directors fully understand and are actively monitoring the organization's exposure to those risks.

A targeted inspection is designed to focus intensively on one or more specific areas, activities, or problems relating to a holding company. Targeted inspections of holding companies with total consolidated assets between $1 and $10 billion should focus primarily on parent company leverage, parent company cash flow, nondepository subsidiaries, consolidated capital (when applicable), and intercompany transactions. Targeted inspections may also cover other applicable areas, such as deficient risk management practices at the holding company.

In addition, because compliance with laws and regulations is a statutory factor that must be considered as part of any supervisory review of an application or notice by the holding company, it is important that Reserve Bank staff ensure that compliance with relevant laws and regulations, including any commitments provided by a holding company in connection with an application or notice, is evaluated and addressed in written inspection reports.

Complex Holding Companies

- If a complex holding company is rated composite "1" or "2," a full-scope, on-site inspection is required annually.
- The following apply for a complex holding company rated composite "3," "4," or "5."
  - A full-scope, on-site inspection is required annually.
  - If the primary supervisor has conducted an interim examination or changed the rating at the lead depository institution, Reserve Bank staff should conduct an additional targeted inspection and update the rating if necessary. The targeted inspection may be conducted off-site and should start within 60 days of receiving the examination report for the lead depository institution.

[3] See SR letter 04-18, "Bank Holding Company Rating System." For SLHCs, see SR letter 11-11 /CA letter 11-5, "Supervision of Savings and Loan Holding Companies (SLHCs)," and SR letter 13-8 /CA letter 13-5, "Extension of the Use of Indicative Ratings for Savings and Loan Holding Companies," concerning indicative ratings of SLHCs.

- Additional follow-up, including interim inspections between regular full-scope, on-site inspections, may be required in response to off-site surveillance program results.

Noncomplex Holding Companies

- If a noncomplex holding company is rated composite "1" or "2," an off-site targeted inspection is required every two years.
- The following apply for a noncomplex holding company rated composite "3," "4," or "5."
  - A full-scope, off-site inspection is required annually.
  - If the primary supervisor has conducted an interim examination or changed the rating at the lead depository institution, Reserve Bank staff should conduct an additional targeted inspection and update the rating if necessary. This targeted inspection may be conducted off-site and should start within 60 days of receiving the examination report for the lead depository institution.
- Additional follow-up, including interim inspections between regular full-scope inspections, may be required in response to off-site surveillance program results.

Frequency and Scope of Review of Holding Companies with Less Than $1 Billion in Total Consolidated Assets

The supervisory cycle for these holding companies is determined by the examination frequency of the lead depository institution. Complex companies in this size category are assigned a complete RFI rating; others are assigned only a risk management rating and a composite rating. All ratings assigned should be promptly entered into the National Examination Database (NED) and communicated to the company, Board staff, and appropriate state and federal regulatory authorities as soon as possible, but generally no later than 90 days after receipt of the lead depository institution examination report.

Although off-site review of small holding companies will be appropriate in many cases, in some instances it may be necessary to conduct an on-site review, as discussed below. In those cases when an on-site review is required, the findings of that review and the assigned ratings should be communicated to the company no later than 120 days after receipt of the lead depository institution examination report. Documentation for the ratings and off-site or on-site reviews will generally consist of the examination reports for the depository institution subsidiaries, a copy of the transmittal letter communicating the ratings to the company, information related to relevant System surveillance results, and memoranda supporting any on-site review conducted. A meeting between Reserve Bank staff and the company's board of directors to communicate findings is not required, but should be conducted when warranted by supervisory concerns.

Complex Holding Companies

- An off-site review should be conducted upon receipt of the lead depository institution examination report or an updated rating from the primary supervisor using surveillance results and relevant supervisory and financial information. If the information obtained off-site is not sufficient for the Reserve Bank to determine the overall condition of the company and to assign a complete RFI rating, the Reserve Bank should conduct an on-site review of the company.

- Any on-site review should be targeted at those areas where additional information or analysis is needed to assign a complete supervisory rating.

Noncomplex Holding Companies

- If all subsidiary depository institutions have a management component rating and a composite supervisory rating of "1" or "2" and no material holding company issues are otherwise indicated, the Reserve Bank should assign only a composite rating and risk management rating to the holding company based on the ratings of the lead depository institution.
- If one or more subsidiary depository institutions have a management component rating or a composite supervisory rating of "3," "4," or "5" or a material holding company issue is otherwise indicated, an off-site review is required upon receipt of the lead depository institution examination report or an updated rating from the primary supervisor using surveillance results and relevant supervisory and financial information. If the information obtained off-site is not sufficient for the Reserve Bank to determine the overall condition of the company and to assign a risk management rating and a composite rating, an on-site review should be conducted.
- Any on-site review should be targeted, as appropriate, at those areas where additional information or analysis is needed to develop the risk management and composite ratings.

Surveillance Guidelines for Holding Companies with Less Than $1 billion in Total Consolidated Assets

Upon the receipt and finalization of FR Y-9 data, Board surveillance staff provides each Reserve Bank with the results of the small holding company surveillance screens on a quarterly basis. Reserve Banks should evaluate this information and make a determination as to any appropriate supervisory actions within 45 days of receipt. In doing so, Reserve Banks should determine whether the screen results reveal that the holding company or its affiliates could pose or exacerbate a material risk to a depository institution subsidiary. If the screen results reveal no basis for a significant concern, a short note to examination files documenting this conclusion should be prepared and no further action is required.

If a Reserve Bank determines that the screen results reveal the potential for material risk to a depository institution, the Reserve Bank should take appropriate follow-up action within 90 days after initially receiving the surveillance results from the Board. Follow-up actions may include:

- Contacting the holding company to obtain more information,
- Requesting from the holding company a corrective action plan,
- Implementing heightened monitoring procedures, or
- Commencing an on-site review.

In most cases, follow-up action may be completed off-site. If an on-site review is recommended, the review should commence within 90 days of the Reserve Bank's initial notification of the surveillance results from the Board. The ratings assigned as a result of the on-site review should be promptly entered into NED and communicated to the company, Board staff, and appropriate state and federal regulatory authorities within 120 days of that notification.

Questions and Contact Information

Questions or comments concerning the inspection activities of holding companies should be directed to Richard Watkins, Assistant Director, at (202) 452-3421. For questions regarding the supervision of savings and loan holding companies, contact Karen Caplan, Manager, Savings and Loan Holding Companies, at (202) 452-2710. Questions regarding small holding company surveillance activities should be directed to Matthew Mattson, Manager, Monitoring and Surveillance, at (202) 452-2943. In addition, questions may be sent via the Board's public website.[4]

Michael S. Gibson
Director

Attachment:

- *Small Holding Company Inspection Scope and Frequency*

Supersedes:

- SR letter 02-1, "Revisions to Bank Holding Company Supervision Procedures for Organizations with Total Consolidated Assets of $5 Billion or Less"

Cross-References:

- SR letter 13-10, "Format for Safety-and-Soundness Reports of Examination and Inspection for Community State Member Banks and Holding Companies Rated Composite '4' or '5'"
- SR letter 13-8 / CA letter 13-5, "Extension of the Use of Indicative Ratings for Savings and Loan Holding Companies"
- SR letter 11-11 / CA letter 11-5, "Supervision of Savings and Loan Holding Companies (SLHCs)"
- SR letter 04-18, "Bank Holding Company Rating System"

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4 See http://www.federalreserve.gov/apps/contactus/feedback.aspx.

Small Holding Company Inspection Scope and Frequency[1]

<table>
<tr><td></td><td>Asset Size</td><td colspan="2">$1-$10 Billion</td><td colspan="2">Less than $1 Billion</td></tr>
<tr><td></td><td>Complexity[3]</td><td>Complex</td><td>Noncomplex</td><td>Complex</td><td>Noncomplex</td></tr>
<tr><td></td><td>Type of Rating</td><td>Complete holding company rating</td><td>Complete holding company rating</td><td>Complete holding company rating</td><td>Risk management rating and composite ratings only</td></tr>
<tr><td rowspan="2">Scope and Frequency[2]</td><td>Rating of 1 or 2</td><td>**Full scope on-site** inspection is required **annually.**

Additional follow-up, including interim inspections between regular full-scope, on-site inspections, in response to off-site surveillance program results.</td><td>**Off-site targeted** inspection is required every **two years**.

Additional follow-up, including interim inspections between regular full-scope inspections, in response to off-site surveillance program results.</td><td rowspan="2">**Off-site review** should be conducted **upon receipt of the lead DI exam report** or **an updated rating** from the primary supervisor using surveillance results and relevant supervisory and financial information. If the information obtained off-site is not sufficient for the Reserve Bank to determine the overall condition of the company and to assign a complete RFI rating, the Reserve Bank should conduct an on-site review of the company.

Any on-site review should be targeted at those areas where additional information or analysis is needed to assign a complete supervisory rating.</td><td>If all subsidiary DIs have a management component rating and a composite supervisory rating of “1” or “2” and no material holding company issues are otherwise indicated, the Reserve Bank should **assign only a composite rating and risk management rating to the holding company based on the ratings of the lead DI**.</td></tr>
<tr><td>Rating of 3, 4, or 5</td><td>**Full scope on-site** inspection is required **annually.**

If the primary supervisor has conducted an interim examination or changed the rating at the lead depository institution (DI), the Reserve Bank should conduct an additional targeted inspection and update the rating if necessary. The targeted inspection may be conducted off-site and should start within 60 days of receiving the examination report for the lead DI.

Additional follow-up, including interim inspections between regular full-scope, on-site inspections, in response to off-site surveillance program results.</td><td>**Full-scope off-site** inspection is required **annually**.

If the primary supervisor has conducted an interim examination or changed the rating at the lead DI, the Reserve Bank staff should conduct an additional targeted inspection and update the rating if necessary. This targeted inspection may be conducted off-site and should start within 60 days of receiving the examination report for the lead DI.

Additional follow-up, including interim inspections between regular full-scope inspections, in response to off-site surveillance program results.</td><td>If one or more subsidiary DIs have a management component rating or a composite supervisory rating of “3,” “4,” or “5” or a material holding company issue is otherwise indicated, an **off-site review** is required **upon receipt of the lead DI exam report** or **an updated rating** from the primary supervisor using surveillance results and relevant supervisory and financial information. If the information obtained off-site is not sufficient for the Reserve Bank to determine the overall condition of the company and to assign a risk management rating and a composite rating, an on-site review should be conducted.

On-site reviews should be targeted at those areas where additional information or analysis is needed to develop the risk management and composite ratings.</td></tr>
<tr><td rowspan="2">Report Requirements</td><td>Rating of 1 or 2</td><td colspan="2">Standard inspection report format as noted in Section 5010.1, “Procedures for Inspection Report Preparation,” in the *Bank Holding Company Supervision Manual*</td><td colspan="2" rowspan="2">Off-site or on-site reviews will generally consist of the exam reports for the insured DI subs, a copy of the transmittal letter communicating the ratings to the company, info. related to relevant surveillance results, and a memo supporting any on-site review conducted</td></tr>
<tr><td>Rating of 3, 4, or 5</td><td colspan="2">Letter-format report of inspection may be prepared as indicated in SR 13-10, “Format for Safety-and-Soundness Reports of Examination and Inspection for Community State Member Banks and Holding Companies Rated Composite ‘4’ or ‘5’.”</td></tr>
</table>

1.) The scope and frequency guidelines listed above are applicable to bank holding companies and savings and loan holding companies.
2.) Full-scope inspection covers all areas of interest to the Federal Reserve in depth; targeted inspections will focus intensely on one or two activites. See the *Bank Holding Company Supervision Manual* Section 5050.0, "Procedures for 'Targeted' Inspection Report Preparation," for more information.
3.) Complexity factors include the size and structure of the company; the extent of intercompany transactions between insured depository institution subsidiaries and the holding company or uninsured subsidiaries of the holding company; the risk, scale and complexity of activities of any nondepository subs; and the degree of leverage at the holding company, including the extent of its debt outstanding to the public. Other factors are also noted in the text of SR-13-21 "Inspection Frequency and Scope Requirements for Bank Holding Companies and Savings and Loan Holding Companies with Total Consolidated Assets of $10 Billion or Less."